The Optional Federal Charter: Implications for Life Insurance Producers

Prepared by

Laureen Regan, Ph.D.
Associate Professor
Fox School of Business and Management
Temple University
Philadelphia, PA 19122
215-204-7264

for the American Council of Life Insurers
and the National Association of Independent Life Brokerage Agencies

September 10, 2007

Executive Summary

The National Insurance Act of 2007 (NIA) was introduced by Senators John Sununu (R-NH) and Tim Johnson (D-SD) in May of 2007 to allow for the creation of an optional federal charter for insurers and insurance producer regulation. Prior research has examined the impact of an optional federal charter on both life insurance carriers and on consumers. This study focuses on the potential impact on life insurance producers.

Under the state-based system, insurance producers must be licensed in each state in which they sell insurance. Insurance producers currently carry an average of 7.9 separate licenses per producer[1]. Under the NIA producers would need one license to sell across all 50 states. The NIA would also eliminate countersignature laws that require an out-of-state agent to have the signature of an in-state licensed agent and to share commissions before selling business in the state.

Despite the adoption of the Producer Licensing Model Act (PLMA) by the National Association of Insurance Commissioners (NAIC) in 2000, there continue to be differences in licensing fees and continuing education requirements across states. For example, the NAIC reports that 59 percent of states were in compliance with the pre-licensing education standard of the PLMA, while just 22 percent were in compliance with the continuing education requirements as of year-end 2005. Uniform, rigorous requirements for pre-licensing and continuing education ensure a well-qualified producer force and enhance consumer protection.

The estimated cost of the current system of producer licensing is $431,733,400 with an assumed cost per license of $100. Under the NIA, savings could range from $268 to $377 million per year in licensing fees alone. Based on Bair (2004), life insurers could save $269 million in direct and indirect costs associated with producer licensing by moving to a federal regulator. These savings would be passed along to consumers in a competitive market.

Product uniformity and speed to market also continue to be an issue for life insurance producers. As of May 30, 2007, 30 states had joined the Interstate Insurance Product Regulation Compact (Compact). The Compact was developed to provide a single-point, uniform system for approval for life insurance products. The system has an expected operational start date of June, 2007. While the Compact shows the promise of streamlining product introduction, unless all states are members true uniformity and speed to market will not be achieved.

The NIA provides for an Office of Consumer Affairs to monitor advertising, sales, and market conduct. The NIA also allows for the creation of self-regulatory organizations (SROs) similar to the NASD to oversee nationally licensed producers and agencies. These SROs would investigate and respond to customer complaints in a uniform

[1] Note that insurance producers also incur costs associated with obtaining appointments to represent insurers, but an analysis of these additional costs is beyond the scope of this study.

manner. Under the state-based system, there are significant differences across states in the rate of complaints per capita, per producer license, and per dollar of insurance premium in the state. This may indicate differences in reporting, customer satisfaction, or intensity of regulatory enforcement across states. A uniform system of market conduct regulation combined with uniformity in products across states would likely result in an increase in customer satisfaction.

One might expect that a national system of regulation would result in increased concentration in product distribution as less efficient producers face increased competition in their home markets. The optional federal charter proposal would allow nationally licensed producers to compete in any state, as well as serve clients over the Internet, with one license. Increased concentration that derives from efficient competition is generally a benefit to consumers to the extent that savings are passed along in the form of lower prices. To the extent that the optional federal charter allows small local producers to access the same products and services as those of the nationally licensed producers, it may benefit them as well.

Introduction

On May 24, 2007, Senators John Sununu (R-NH) and Tim Johnson (D-SD) introduced the National Insurance Act of 2007 (NIA) to allow for the creation of a federal regulator for the insurance industry. Under the NIA, insurers and insurance producers could choose to remain regulated at the state level or to come under the authority of a newly created federal regulator[2]. The Act is a result of continuing criticism of the state-based insurance regulatory structure in areas relating to compliance costs and lack of uniformity across states. More importantly, it is in response to rapid and dramatic changes in the competitive landscape facing insurers resulting from the deregulation of the broader financial service industry in 1999 under the Gramm-Leach-Bliley Act (GLBA), as well as increasing competition from non-U.S. based financial services providers.

There have been several studies of the potential impact of federal regulation on life insurance carriers and on customers (See, for example, CSC, 2003; Bair, 2004) but little attention so far has been paid to the potential impact on insurance producers. This is the focus of the current study. Insurance producer interests must be aligned with both those of the carriers they represent and the customers they serve. Therefore, this analysis will focus on three areas where state-based regulation may impact producer's relationships with their carriers or their customers: licensing, product approvals, and customer service. The structure of the insurance industry is detailed in Section 1 below. Section 2 examines the provisions of the NIA that might be particularly relevant to producers. Section 3 looks at licensing uniformity and costs under the current state system, and calculates savings associated with a federal regulator under several assumptions. Product introduction and uniformity across states is also examined. Customer satisfaction as measured by consumer complaints to state insurance departments is analyzed in this section to determine whether there are significant differences in customer satisfaction across states that are related to state insurance department resources. If so, then an efficiently funded national regulator might generate improvements to customer satisfaction.

Insurance Industry Overview

The United States insurance industry is composed of two sectors, life and health insurance, and property and liability insurance. Life and health insurers provide protection against the risk of premature death, illness, or disability. The major products of the life insurance industry are life, disability, long-term care insurance, and annuities. In life insurance, the predominant factor used as the basis for risk classification and pricing is the age of the applicant at policy issue, with rating modifications based on

[2] The term "producer" is used throughout this paper to refer to an individual that sells insurance, and includes independent and career agents, brokers, and any other entity that holds a license to sell insurance.

gender, health, family history, habits, and activities. Life insurer loss payout patterns do not show significant variation across geographic regions of the United States, and do not vary much from year to year. Whether the premiums are paid by individuals themselves, or by groups including employers, on the individual's behalf, the underlying value at risk is an individual life. As of year-end 2005, life and health insurers collected over $535 billion in premiums and paid out $467 billion in benefits (Life Insurers Fact Book, 2006).

Property-liability insurance protects against the financial costs of physical damage to property, and provides legal defense and damages costs associated with liability claims against insured individuals and entities. The risk factors that affect individual insureds are very different than those that affect commercial insureds. There are also important differences across local and national geographic regions in the factors that can cause damage to property, and these result in differences in insurance rates for similar property located in a different geographic region. For example, hurricane, flood, wildfire, earthquake, and tornado risk varies significantly across the country. The laws that govern standards of liability also differ across states, resulting in differences in estimated loss profiles across states. Further, property-liability claims patterns show large variation across time, with very large losses in some years.

Because of differences in underlying values insured across insurance sectors, and also because of regional and time differences in the patterns of loss payouts, regulatory and business constraints facing life insurers are very different from those facing property-liability insurers. Therefore, this study will focus only on the life insurance sector.

The life insurance industry plays an important role in the U.S. and global economies. The U.S. life insurance market is the largest in the world. In 2005, global life insurance premium volume was over $1.97 trillion[3], with the United States accounting for over $535 billion, or 26 percent of the world market (Swiss Re, 2006). The life insurance sector accounts for 4.14 percent of U.S. GDP and 4.34 percent of global GDP. The life insurance sector is larger than the non-life sector globally, accounting for 57.6 percent of world insurance market share, but falling to 45.2 percent of U.S. insurance market share based on premiums. Figure 1 shows the growth in the U.S life insurance market since 1995. Premiums collected increased by 53 percent over the period, almost double the rate of general inflation. Figure 2 shows the breakdown of insurance premiums by product, with annuities accounting for 51 percent of industry premium.

---

[3] This includes life and annuity premium only. Credit, accident and health insurance premiums are excluded in global premium volume.

Figure 1
Life Insurance Industry Premiums, 1995-2005

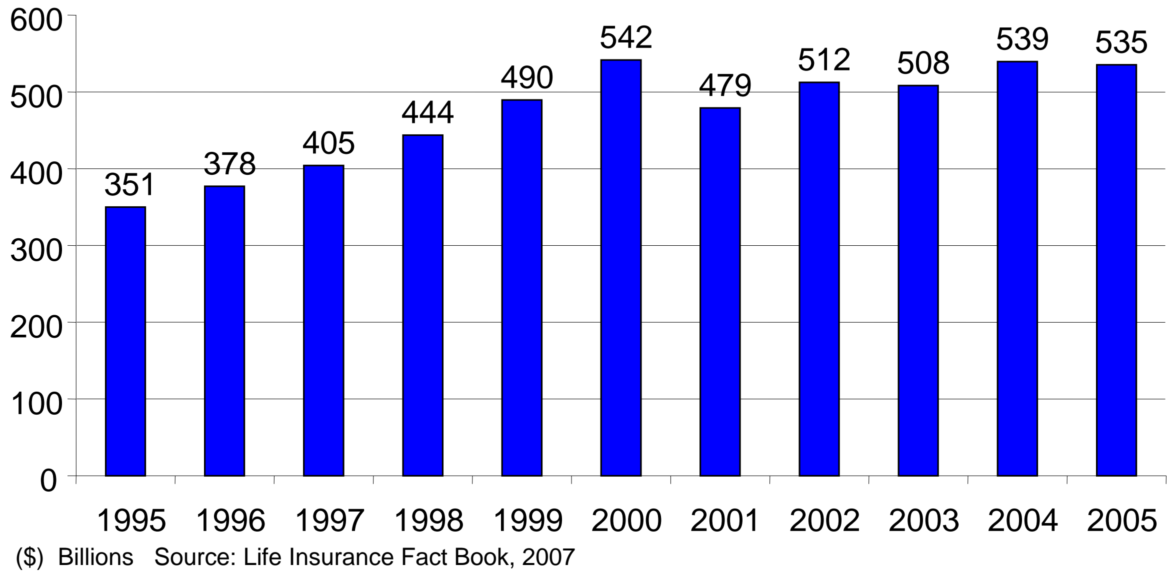
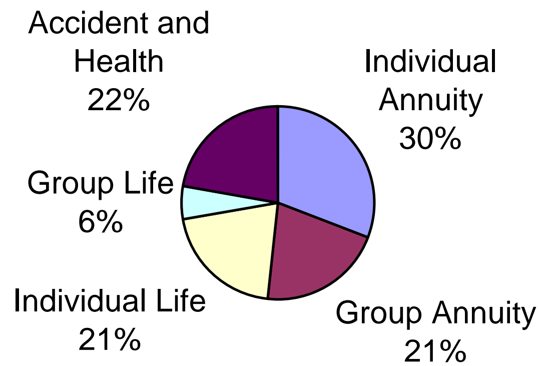


Figure 2
Life Insurance Premium by Product, 2005



Source: Insurance Fact Book, 2007, (Insurance Information Institute)

Life insurers' role in pension and retirement planning is particularly important as the baby boom generation nears retirement. According to the 2000 U.S. Census, there are approximately 83 million Americans born between 1946 and 1964, representing approximately 35 percent of the working-age population. The earliest members of this group are nearing retirement, and will face significant responsibility for their own financial planning as fewer employers offer traditional defined benefit pension plans, and as the social security system faces potential funding shortfalls. This generation is also expected to be the beneficiary of a large wealth transfer as their parents bequeath assets to their surviving children, and will require appropriate advice and an array of products to help preserve and grow these assets. Further, many will be responsible for caring for aging parents, and for planning for their own care as they age. This increases the demand for asset preserving products including life insurance, long-term care and disability insurance.

The Optional Federal Charter

Since the Gramm-Leach-Bliley Act (GLBA) of 1999 deregulated the financial services industry in the U.S. there has been increasing competition among and across industry sectors, with commercial banks and securities dealers becoming more involved in the insurance industry. Under current law, commercial banks have the option of being regulated by a single federal authority or at the state level, while securities dealers are regulated at the federal level. Life insurers, however, are regulated by the states in which they are licensed to operate. That means that a life insurer operating nationally must report to up to 51 regulatory bodies.

It has been argued that the state-based regulatory framework puts life insurers at a considerable competitive disadvantage, especially in a period of greater financial modernization and increasing global competition. The state based regulatory system has been criticized for lack of uniformity in products, producer and insurer licensing, market conduct and financial examination requirements, delays in product introduction and modifications across states, and other areas. The state-based system is argued to be slow and unduly costly, and results in a competitive disadvantage for life insurers and producers as compared to federally regulated sectors of the financial services industry offering similar products. For example, state licensed life insurance producers can not sell insurance to existing customers who move out of the state without holding a non-resident license in that state. Advocates for changing the regulatory structure argue that a federal regulator would even the playing field for life insurers, allowing them to compete more effectively with banks and securities dealers, and benefit customers by giving them access to the most advanced products at the lowest cost.

The recently introduced NIA would create an Office of National Insurance within the Treasury Department, with a Commissioner appointed by the President to serve a five year term. There would be at least six regional offices as well. Insurers would have the

option to be regulated by the national regulator, or to stay in the state-based regulatory system. The Act also

"*authorizes the chartering and licensing of National Insurance Agencies and the licensing of federal insurance producers. A National Agency would be authorized to sell insurance for any federally chartered or State licensed insurer. A federally licensed insurance producer could sell insurance, including surplus lines of insurance, in any State on behalf of any National Insurer or a State Insurer. Additionally, a State licensed insurance producer could sell insurance on behalf of any insurer, including National Insurers, operating within the State in which the producer holds a license." (Press release, SUNUNU, JOHNSON: MARKETPLACE DEMANDS INSURANCE REGULATORY REFORM, Thursday, May 24, 2007)*

This language indicates that a federal producer would hold a single license to sell products in a line of insurance in any state without additional licensing requirements. The Act also includes a provision to allow the Office of National Insurance to register self-regulatory organizations similar to the National Association of Securities Dealers (NASD) to supervise federal producers and national agencies in the areas of licensing and market conduct.

The NASD currently supervises 650,000 registered securities dealers, similar to the number of licensed insurance producers in the market. There are approximately 5,100 registered broker/dealer firms that trade securities in the U.S. Both the NASD and the New York Stock Exchange (NYSE) act as SROs with respect to broker/dealer firms operating on either the NASDAQ, the NYSE, or both exchanges. Firms that operate on both exchanges have been regulated separately by each exchange in the past. In January, 2007, the exchanges agreed to consolidate regulation so as to increase uniformity, decrease regulatory costs for member firms, and increase consumer protections[4]. The new SRO will be responsible for market conduct regulation, compliance, licensing and continuing education for all securities firms doing public business in the U.S. In anticipation of cost savings arising from regulatory consolidation from two authorities to one, the NASD plans to distribute a one-time lump sum payment of $35,000 to member firms along with reducing annual dues payable by member firms to the NASD by $1,200 per year for five years, for a total expected cost savings of $209 million passed back to member firms.

There are additional provisions in the NIA to protect consumers. The Office of National Insurance would include a Division of Insurance Fraud to investigate fraud by insurers, agencies, producers, or other persons. The Division of Consumer Affairs would have the authority to enforce market conduct regulations regarding advertising, sales and marketing practices, and claims settlement practices.

The Optional Federal Charter Coalition trade group supports the NIA. Members include Agents for Change, American Bankers Association, American Bankers Insurance

---

[4] For a detailed discussion of the regulatory consolidation plan, see http://www.nasd.com/RegulatoryConsolidation/generalInformation/ConsolidationFacts/index.htm

Association, American Council of Life Insurers, American Insurance Association, The Council of Insurance Agents and Brokers, The Financial Services Forum and The Financial Services Roundtable, National Association of Independent Life Brokerage Agencies, Reinsurance Association of America, and the Life Insurers Council. Note that the latter two members joined the coalition since 2006. There is also support from some individual insurance companies in both the life and property-liability sectors.

Opponents of the proposal at the industry level are primarily in the property-liability sector. They argue that the state-based system does not work perfectly, but that the states are better able to regulate the industry with some improvements, because property-liability insurance is local in nature. Among this group is the Independent Insurance Agents and Brokers of America, the largest industry group representing primarily property-liability insurance producers, the National Association of Mutual Insurance Companies, and the National Association of Professional Insurance Agents, also a property-liability insurance agency group.

Below we examine important issues for life insurance producers associated with the state-based regulatory system and question whether an optional federal regulatory system might alleviate these.

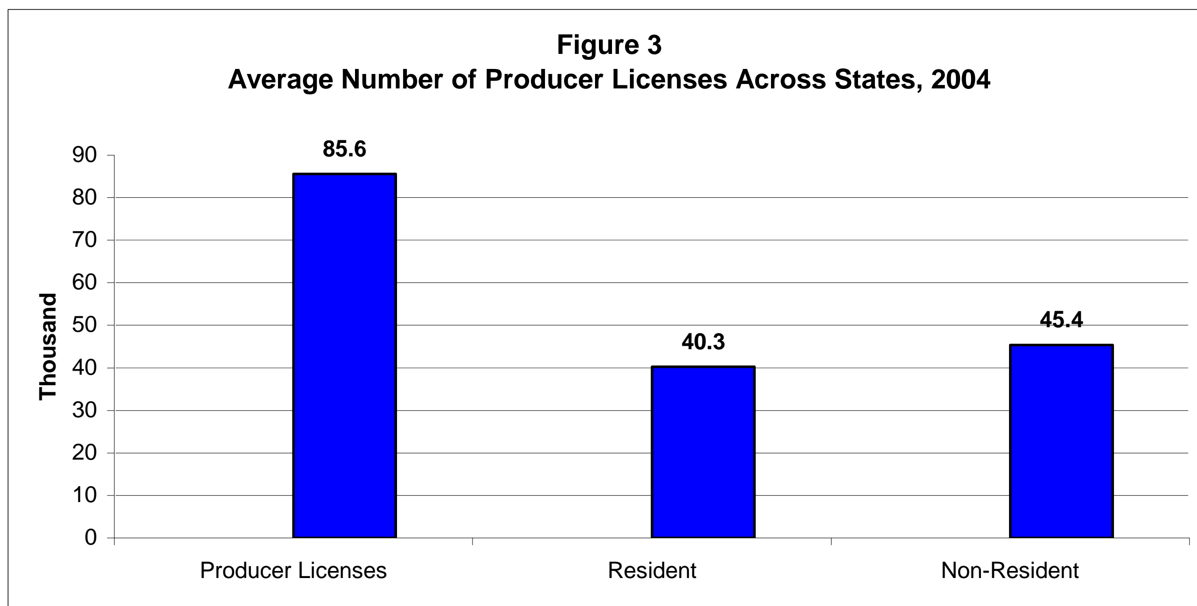
Producer Licensing, Product Innovation and Uniformity, and Customer Satisfaction

1. Licensing

Licensing requirements can act as a barrier to entry to markets, often limiting competition and constraining supply of goods and services. Under state-based insurance regulation, producers, agencies, and insurers must hold licenses for each state and line of business in which they operate. Under the GLBA, a majority of states were required to either adopt uniform non-resident producer licensing laws, or enter into reciprocity agreements with other states by a November, 2002 deadline. If this requirement was not met, a federal self-regulatory organization, the National Association of Registered Agents and Brokers (NARAB) similar to the NASD would be created to manage producer licensing. In response, the states made significant progress in streamlining producer licensing requirements and in encouraging uniformity and non-resident producer licensing reciprocity across states.

The GLBA deadline was met, with the majority of states entering into reciprocity agreements rather than adopting uniform standards, so the NARAB was not implemented. Under reciprocity agreements, if a producer is licensed as a resident in a reciprocal state (State A) and seeks a non-resident license outside the state (State B), the non-resident licensing state (State B) accepts the licensing qualifications of the producer's home state (State A) to the extent that the home state (State A) accepts the qualifications of the non-resident state's (State B) producers seeking a non-resident license there (State A). Thus, under reciprocity rather than uniformity, licensing and education qualifications of producers vary within states depending on the requirements

of the non-resident producer's home state. Figure 3 shows the average number of resident and non-resident producer licenses per state for 2004[5].



Despite the progress made in licensing reciprocity, there is still little uniformity in producer licensing across states. The Producer Licensing Model Act (PLMA) was adopted in 2000 to bring uniformity to licensing regulation across states. However, differences continue to exist for pre-licensing education requirements, post-licensing continuing education requirements, treatment of non-resident producers, and licensing and examination fees across states.

For example, in Pennsylvania, the producer licensing fee is $55.00 for residents and $110.00 for non-residents. In Maine, the resident license fee is $45.00 and the non-resident fee is $85.00. Texas has a licensing fee of $50.00. The resident producer license fee in New York is $80.00, and the non-resident license fee is a minimum of $80.00, with higher fees depending on the producer's resident state. Non-resident license fees for life, accident, and annuities lines range from $80.00 to a total of $280 in Georgia and Oklahoma, and $300.00 for New York non-resident producers domiciled in Hawaii. Similarly, in California, the resident license fee is $144, and it is a minimum of $144 for non-resident licenses, and higher if the domicile state charges a higher non-resident fee to California resident producers[6].

Perhaps more importantly, there are significant differences in state pre-licensing education requirements and continuing education requirements across states. For example, Pennsylvania requires 24 hours of pre-licensing education and 24 hours of continuing education over a two-year period. Texas requires no pre-licensing education,

---

[5] This data is from the Insurance Department Resources Report of the NAIC.
[6] Source: Author's search of state insurance department websites as of May, 2007.

and 30 continuing education hours over a two-year period. Illinois requires 40 hours of pre-licensing education and 15 hours of continuing education over a two-year period. The NAIC reports that 59 percent of states were in compliance with the pre-licensing education standard of the PLMA, while just 22 percent were in compliance with the continuing education requirements as of year-end 2005[7]. Do these differing requirements result in different levels of producer quality across states, or is there one base level of education that all producers should attain? Are there implications for customer service across states with different professional qualification standards? These questions are beyond the current study, but certainly should be examined in the context of the regulation debate.

Lack of uniformity in producer licensing and the need for multiple licenses for producers operating across states continues to impose substantial costs. The NAIC reports that there were 4,314,337 insurance producer licenses held in 2004 across all lines of insurance. On average, each insurance producer holds 7.9 separate licenses.[8] Assuming a cost, including fees and continuing education, of $100 per license per year, the total direct cost of insurance licensing per year is $431,733,400. Under a uniform licensing system with a single license covering all states and lines of business, insurance producer licensing costs could decline to $54,390,800. Even if a producer held separate licenses for life, health, and property-liability lines, licensing costs would reach only $163,172,400, just 38 percent of current levels. Table 1 summarizes these results. Note that these are conservative estimates since the Bureau of Labor Statistics does not report data for self-employed producers.

Table 1
Producer Licensing Cost Estimates

	Current System	Single National License	Major Lines National License
Total US insurance licenses outstanding	$431.4 M	$54.4 M	$163.2 M
Average number of licenses per producer	7.9	1	3
Assumed cost per license	$100.00	$100.00	$100.00

[7] Source: The Producer Licensing Uniformity Survey, accessed May 31, 2007 at http://www.naic.org/documents/committees_d_plwg_uniform_licensing_survey.xls

[8] The Bureau of Labor statistics reports that 627,346 people were employed in insurance agencies and brokerages in 2002, the last year the data is reported. The author assumes a 2% growth rate that matches the U.S. population growth, and that 85 percent are licensed producers and15 percent are non-licensed support staff. This is consistent with Smith, et al (2000). Based on this, I calculate that there are 543,908 insurance producers.

This analysis does not include costs for NASD licensing. Approximately 69 percent of all life insurance agents also hold a NASD license, rising to 80 percent of career agents (Smith et al, 2000). The NASD Series 6 license allows producers to sell variable annuities under one license across all states. The license exam fee is $75.00, comparable to what a life insurance producer would pay to hold a single state license.

Bair (2004) estimates that total life insurance industry regulatory costs borne by insurers range from $892 million to $961 million, with 28 percent of this, or $269 million, attributable to producer licensing. The cost to an insurer of licensing a single producer in one additional state is equal to $136. Using this as a basis, the cost for a single producer to hold one license in all 50 states is $6,800. Note that this estimate does not include continuing education costs.

According to a recent survey of wholesale life agencies by the National Association of Independent Life Brokerage Agencies (NAILBA), the average agency devotes 37 hours per month to producer licensing. That is the equivalent of one week of support staff time solely devoted to licensing compliance, at an average annual cost of $8,850[9] per agency. This is in addition to the average direct licensing fees and costs per agency of $12,600 per year. The average wholesale life brokerage agency responding to the survey was licensed in 31 states. With over 350 wholesale life insurance brokerage agency members, licensing costs for this segment amount to an aggregate of just over $7,500,000 per year at the agency level. (NAILBA, 2007)

2. Product Approval

Life insurance products are subject to approval by the states in which they are offered. Standards across states vary, as does the time it takes to get a new product approved or an existing product modified. This results in variations of the same product across states, and in some cases, a product approved in one state may not be approved in others. In a recent survey, 79 percent of life insurers reported that they created state-specific products, and on average had 18 variations of the products they issued (CSC, 2005). Massachusetts Mutual reports that it commonly has 30 to 40 variations of each product, and has 48 variations for one particular product (Fisher, 2003). Seventy-one percent of wholesale agencies surveyed by NAILBA (2007) reported that the lack of state approval coordination had impacted business. Seventeen individual states were mentioned as having particularly difficult approval processes.

To address life insurance product uniformity and speed to market concerns, the National Association of Insurance Commissioners introduced the Interstate Insurance Product Regulation Compact (Compact) in 2002. The Compact establishes a Commission that is responsible for the development of uniform approval standards for life insurance products and product-related advertisements. Members of the commission review filings and issue product approvals. Once a product is approved, it may be used in any member state without further modification. There is one central

[9] This is based on average annual support staff salary of $36,878 as reported by Krozel, (2005), allocated to one week per month of licensing compliance time.

electronic filing point for products with one set of requirements. The commission would become effective when 26 states agree to become members of the Compact. As of May, 2007, the Compact has 30 member states and has a targeted start date to become operational by June, 2007.

The Compact will allow producers to offer identical products across the 30 member states, and will likely reduce product approval delays. Consumers would have access to a broader array of products at lower prices. However, unless all states become members of the Compact, true uniformity and speed to market will not be reached.

3. Customer Service

An important measure of customer satisfaction with the insurance industry is the number of complaints made against it. Complaints are made when service quality falls short of expectations[10]. Monitoring complaints is important in insurance regulation because it highlights potentially problematic areas in insurance markets or firms. Several studies have used complaints as a measure of insurance service quality. Doerpinghaus (1991) uses firm-level complaint rates provided by state insurance departments as a measure of service quality differences in automobile insurance. Barrese, Doerpinghaus, and Nelson (1995) examine differences in complaints against property-liability insurers using different distribution systems. Born and Query (2004) use complaint data to measure customer satisfaction with managed healthcare plans. Solnick and Hemenway (1992) also examine customer satisfaction with managed healthcare plans and find that patients who file complaints are over four times as likely to leave the plan as those who do not file complaints.

State insurance departments are responsible for investigating and responding to customer complaints about insurance products or services. As noted above, the NIA would establish a Division of Consumer Affairs that would review and respond to complaints. Bair (2004) notes that the majority of complaints made against life insurers are related to producer misconduct and claims handling. Life insurance producers are interested in maintaining and enhancing the reputation of their industry, and should welcome regulatory change that increases customer satisfaction with the industry.

One way to measure the effectiveness of the current regulatory system is to examine differences across states in the rate of complaints made against insurers. The NAIC collects complaint and insurance department funding data from the states, and the 2005 data (the latest available) is used in the analysis that follows[11]. There were a total of almost 420,000 complaints filed against insurers in 2005, an average of almost 8,400 per state. There is significant variation in the number of complaints filed per capita across states. Delaware has the highest rate of complaints per capita, with 5.43 per

[10] It is important to note that some people who are dissatisfied do not file complaints, so that the actual number of reported complaints likely under-reports customer dissatisfaction in general.
[11] Caution should be used in interpreting these results. Since there is little uniformity across states with respect to complaint filings and reporting, there may be slight inaccuracy in the data reported here.

1,000 population, while Tennessee reports the lowest rate of complaints, at 0.09 per 1,000 people.

It is well known that there are large differences in insurance department budgets across states, and this is often cited as a cause of uneven application of regulatory oversight across states. One might expect that budget constraints would affect the efficiency of complaint investigation and response across states. There are several ways to compare relative insurance department funding across states. One way is to adjust the budget allocation by state population. This is useful since it is clear that larger states have larger budgets overall, and also since insurance regulation is designed to protect insurance consumers in states. Using this measure, the average budget per 1,000 population is $4,481, ranging from a low of $539 in Michigan, to a high of $23,060 in Delaware.

One might argue that a more appropriate measure is to adjust the budget by the size of the insurance industry in the state. Using state insurance premiums to capture market size, we calculate the budget per $1000 in direct premium revenue (DPW). On average, states allocate $1.23 per $1000 of premium revenue for insurance regulation, and this ranges from $0.27 in Florida to $12.69 in Hawaii.

Finally, since we are interested in the impact of state-based regulation on insurance producers, we also measure the ratio of insurance department budget to producer licenses in the state. As noted above, there were 4,314,337 insurance producer licenses issued in 2004, with an average of 86,286 per state. Since it is unlikely that the growth in the number of insurance licenses outstanding between 2004 and 2005 was significant, we use the 2004 data for this analysis. Based on producer licenses, the average budget rate per state is $236.37, with a low of $44.19 in Michigan, to a high of $1,376 in neighboring Wisconsin.

To determine whether differences in customer satisfaction as measured by complaints are related to these budget differences, we first divide the states into two sets of twenty states each, omitting the ten middle states. In the first set, the twenty states that have the lowest ratings on each of the three measures above are included. The other set includes the states that scored the highest on the three budget measures. Then, we calculate the ratio of complaints per 1,000 population, complaints per $1,000 in premium revenue, and complaints per producer licenses. A test is constructed to determine whether there are statistically significant differences in the average value of the ratios for each of the two sets that are correlated with differences in state insurance department budgets[12]. Table 2 shows the average values and the standard deviation for each of the six measures for all states. There is large variation across states for all of the measures.

[12] A small sample t-test is used to test for significant differences in the means of the two sets of state observations. If the test-statistic returns a value less than 10%, the test indicates that the differences in means is not due to chance, but reflects some underlying differences in the sets. Here, that difference is associated with differences in insurance department funding.

Table 2
Insurance Department Budget and Complaint Measures

	Average	Standard Deviation
Budget per 1000 population	$4,481	$4,215
Budget per producer license	$236.37	$222.79
Budget per $1000 DPW	$1.23	$1.79
Complaint per 1000 population	1.53	1.49
Complaint per producer license	0.0815	0.067
Complaint per $1000 DPW	0.000374	0.000336

Note: Figures are derived from the NAIC Insurance Department Resources Report, 2005

Table 3 reports the results of the statistical tests[13]. There are significant differences in state budgets across the lowest and highest ranked states on all three measures. Panel A shows the results for states ranked by population. Although there are budget differences, there is no detectable difference in the ratio of complaints to population across states. The average per capita complaint rate is 1.37 for states that have relatively smaller budgets, and 1.89 for states with relatively larger budgets. States with higher budgets per capita have higher complaint rates per capita. From this, we can not conclude that greater insurance department resources are associated with higher customer satisfaction with the insurance industry. However, this might indicate that states with larger budgets are more efficient in collecting and reporting complaint data than are less well-funded states.

Panel B indicates the results of the test when states are ranked by insurance department budget per direct premiums. Here, both the difference in average relative budgets and the rate of complaints per premium are statistically different across the lowest and highest ranked states. We find that states that have a higher budget per premium rate have a higher complaint rate than states that have relatively smaller budgets. The budget per premium revenue is 4.37 times larger for the highest value states than for the lowest value states, while the complaint rate is relatively lower, at 1.4

[13] Although not reported here, there are quite significant differences across states in complaints per 1000 population, complaints per $1000 DPW, and complaints per producer license. The differences in the averages for the lowest and highest ranked states is statistically significant at better than the 1% level for all three measures, indicating that there is some systematic difference in the patterns of complaints reported across states.

times as high. One might argue that, because the states with higher rate of budget to direct premium volume simply have higher premiums per capita, they should see higher complaint rates since there is relatively more insurance premium per person. However, there is no systematic difference in premium volume per person across states here. The lowest ranking states based on budget per premium volume had $4,454 in insurance premiums per person, while the highest ranking group had an average of $4,030 per person.

Similar results hold for the comparison of complaint rates by producer licenses in the state when the states are ranked by insurance department budget per producer license. Panel C indicates both higher complaints per license and higher budgets per license across the two sets of states.

Table 3
Insurance Department Budgets and Customer Complaints

A.	States Ranked by Budget Per 1000 population		
	Lowest Ranked States Average	Highest Ranked States Average	
Complaint per 1000 population	1.37	1.891	
Budget per 1000 population	$2,069	$7,495	***
B.	**States Ranked by Budget Per $1000 DPW**		
	Lowest Ranked States Average	Highest Ranked States Average	
Complaint per $1000 DPW	0.00027	0.00039	*
Budget per $1000 DPW	$0.495	$2.166	***
C.	**States Ranked by Budget Per Producer License**		
	Lowest Ranked States Average	Highest Ranked States Average	
Complaint per producer license	0.059	0.108	**
Budget per producer license	$109.34	$392.83	***

Note: ***. **, * Indicate statistically significant differences in averages.

DPW = direct premium written in all lines of insurance in the state

Taken together, this analysis of the relation between insurance department funding and customer satisfaction indicates significant differences in funding across states, as well as significant differences in consumer complaints across states. It is clear, though, that there is no relation between higher insurance department budgets and greater customer satisfaction as measured by lower complaint rates.

From a life insurance producer's perspective, if a federal regulator can increase customer protection levels, minimize differences in products across states, and minimize claims-related disputes, customer satisfaction should increase.

Conclusion

It seems likely that life insurance producers, and thus consumers, could benefit from uniform, single-point, national regulation of the life insurance industry. There are significant differences in costs of producer licensing across states, as well as a lack of uniformity in licensing and continuing education requirements that might result in uneven quality across states. There are also still barriers to true product uniformity and speed to market across states despite the NAIC's Interstate Insurance Product Regulation Compact. As of May, 2007, 30 states had joined the Compact, but uniformity in the product approval process will not be reached until all states become members and all adopt a single standard for product regulation. This means that currently, even if they hold the appropriate licenses, life insurance producers are still not able to offer identical products to consumers in different states. Further, the product approval process will still result in delays, especially as compared to competitors in other sectors of the financial services industry.

Significant differences in insurance department regulatory resources across states continue to exist as well. If the departments that are relatively underfunded are less capable of monitoring insurers and producers within the states, then a more efficient federal regulator might decrease the number of complaints made by consumers, increasing overall satisfaction. Note that this study did not analyze budget differences in relation to the effectiveness of state insurance department regulation overall.

The optional federal charter proposal would allow nationally licensed producers to compete in any state, as well as serve clients over the Internet, with one license. One might expect that a national system of regulation would result in increased concentration as less efficient producers face increased competition in their home markets. However, even under the current system of state regulation there has been considerable consolidation among life insurance agencies over the past few years. For example, as reported in Krozel, (2005), the number of career-agencies has declined almost 60 percent over the past 25 years or so, mostly due to mergers. Today's agencies are larger on average in terms of both revenue and number of agents, while unit costs have declined[14]. Increased concentration that derives from

[14] This study reports that unit costs per agency declined by 2.3% between 2001 and 2003, with larger agencies seeing lower unit costs on average.

efficient competition is generally a benefit to consumers to the extent that savings are passed along in the form of lower prices. To the extent that federal regulation allows small local producers to access the same products and services as those of the nationally licensed producers, it may benefit them as well.

References

ACLI, 2006, *Life Insurers Fact Book*, American Council of Life Insurers.

Bair, Sheila, 2004, *Consumer Ramifications of an Optional Federal Charter for Life Insurers*, manuscript, University of Massachusetts, Isenberg School of Management.

Barrese, James., Helen I. Doerpinghaus, and Jack. M. Nelson, 1995, Do Independent Agents Provide Superior Service? The Insurance Marketing Puzzle. *Journal of Risk and Insurance* 62: 297–308.

Born, Patricia H. and J. Tim Query, 2004, Health Maintenance Organization (HMO) Performance and Consumer Complaints: An Empirical Study of Frustrating HMO Activities. *Hospital Topics: Research and Perspectives on Healthcare,* 82: 2-9.

CSC, 2005, *Economic Impact of an Optional Federal Charter on the Life Insurance Industry: A Survey of Leading U.S. Insurance Companies*, Computer Services Corporation.

Doerpinghaus, Helen I. 1991, An Analysis of Complaint Data in the Automobile Insurance Industry. *Journal of Risk and Insurance* 58: 120–127.

Fisher, William B., 2003, Reforming Insurance Regulation - Making the Marketplace Competitive for Consumers. *Statement of the Massachusetts Mutual Life Insurance Company before the Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises of the House Financial Services Committee.*

III, 2007, *The Insurance Fact Book*, Insurance Information Institute.

Krozel, Kathleen E., 2005, *Agency Expense and Performance Study: U.S. Managerial Companies*, LIMRA International.

NAIC, 2007, *Insurance Department Resources Report*, 2005, National Association of Insurance Commissioners.

NAILBA, 2007, *Survey of Member Opinions and Costs of State Licensing*, National Association of Independent Life Brokerage Agencies. (Preliminary Data)

NASD, 2007, *NASD/NYSE Regulatory Consolidation Overview: Consolidation Facts*, National Association of Securities Dealers, accessed June 24, 2007, at http://www.nasd.com/RegulatoryConsolidation/generalInformation/ConsolidationFacts/index.htm

Smith, Preston, Kenneth N. Isenberg, and Charlene E. Fullerton, 2000, *The Survey of Producer Opinion-United States*, LIMRA International.

Solnick, Sara 0., and David Hemenway, 1992, Complaints and Disenrollment at a Health Maintenance Organization, *Journal of Consumer Affairs* 26: 90–103.

Swiss Re, 2006, World Insurance in 2005: Moderate Premium Growth, Attractive Profitability, *SIGMA*, Swiss Re.